Supreme Court, U. S.
FILED
JAN 13 1979
MICHAEL RODAK, JR., CLERK

No. 78-622

# In the Supreme Court of the United States

OCTOBER TERM, 1978

ROBERT E. and JANE ANN HARDEN CLEMENT, PETITIONERS

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

## MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
*Solicitor General*
*Department of Justice*
*Washington, D.C. 20530*

# In the Supreme Court of the United States

OCTOBER TERM, 1978

---

No. 78-622

ROBERT E. and JANE ANN HARDEN CLEMENT, PETITIONERS

*v.*

UNITED STATES OF AMERICA

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

---

## MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

---

The question presented in this federal income tax case is whether the decision below correctly held that petitioners could not deduct in 1968 their pro rata share of amounts that their partnership expended in December of that year to purchase cattle feed for the subsequent taxable year, where such a deduction would materially distort the partnership's income.

The pertinent facts are undisputed and may be summarized as follows: Petitioners' limited partnership was organized under an agreement filed December 1, 1968, to engage in the business of buying, feeding, and selling cattle. The partnership engaged in only one business transaction in 1968. On December 27, 1968, before the partnership had acquired any cattle, it purchased $311,548 worth of grain warehouse receipts. On its 1968 tax return, the partnership reported this grain expenditure as a business expense and thus claimed a net loss of $311,548 for that year. Petitioners, in turn,

reported their ratable portion (10.9%) of this claimed loss on their 1968 federal income tax return (Pet. App. B-2 to B-6).

On audit, the Commissioner disallowed petitioners' deduction on the ground that it distorted their income for 1968. In this refund suit, the Court of Claims upheld the Commissioner's position, concluding that if petitioners were permitted to "tak[e] the deduction in 1968 instead of 1969 [it would cause] * * * a material distortion of income * * * " (Pet. App. B-17). It therefore ruled that the Commissioner had acted within the authority granted him by the Internal Revenue Code to ensure that taxpayers' methods of accounting clearly reflect their actual incomes when he disallowed the claimed 1968 deduction (Pet. App. A-18 to A-21).

1. The Court of Claims correctly held that petitioners could not deduct the cost of cattle feed for 1968. As this Court noted in *United States* v. *Catto*, 384 U.S. 102, 114 (1966), "Congress has granted the Commissioner [of Internal Revenue] broad discretion in shepherding the accounting methods used by taxpayers." See *Lucas* v. *American Code Co.*, 280 U.S. 445 (1930). Pursuant to Section 461(a), the general Code provision governing the timing of tax deductions, the proper year for a deduction permitted by the Code depends upon the "method of accounting used in computing taxable income."[1] Thus, while Treasury Regulations, Section 1.461-1(a)(1), generally provide that cash method taxpayers such as petitioners shall deduct expenses during the taxable year

[1]Contrary to petitioners' contention (Pet. 12), the Court of Claims did not disregard Treasury Regulations, Section 1.162-12(a). While that provision identifies livestock feed as a deductible expense, Section 461 and the Regulations issued thereunder specifically control the timing of otherwise qualified deductible items. The question of the proper timing of a deduction is determined by the taxpayer's method of accounting, which, in turn, must clearly reflect the taxpayer's income pursuant to Section 446(b).



in which they were paid, the Regulations further state that even a cash basis taxpayer may not claim an immediate deduction for all deductible expenditures. For example, if an expenditure results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year, such expenditure may not be deductible, or may be deductible only in part, during the taxable year in which it is paid. See Section 263. This limitation is grounded on the Commissioner's discretionary authority to require that a method of accounting clearly reflect income. 26 U.S.C. 446(b). *Sandor* v. *Commissioner*, 536 F. 2d 874 (9th Cir. 1976); *Burck* v. *Commissioner*, 533 F. 2d 768 (2d Cir. 1976); *Commissioner* v. *Boylston Market Ass'n*, 131 F. 2d 966 (1st Cir. 1942). See H.R. Rep. No. 1337, 83d Cong., 2d Sess. A161 (1954); S. Rep. No. 1622 83d Cong., 2d Sess. 305 (1954).

Here, petitioners do not challenge the Court of Claims' conclusion that the payment for grain warehouse receipts on December 27, 1968, resulted in the creation of an asset having a useful life extending substantially beyond the close of the taxable year ending December 31, 1968 (Pet. App. A19). Nor do they contest the court's finding that a failure to prorate the grain expense deduction over the period of actual use would result in a material distortion of income. Given these findings, which are fully supported by the record, the court below was obliged but to sustain the Commissioner's determination that petitioners could deduct the feed grain expenditure when the grain was used and not when it was purchased. Rev. Rul. 75-152, 1975-1 Cum. Bull. 144; *Stice* v. *United States*, 540 F. 2d 1077 (5th Cir. 1976).

2. Contrary to petitioners' contention (Pet. 9-11), the decision below does not conflict with *Security Flour Mills Co.* v. *Commissioner*, 321 U.S. 281 (1944). Indeed, that case supports the Commissioner's determination here. As the Court noted in that case (*id.* at 285), the

Commissioner's authority to require that deductions be taken at such times as to produce "undistorted" income reports was designed to prevent the creation of artificial losses by the prepayment of expenses applicable to the production of future income.

*Cravens* v. *Commissioner*, 272 F. 2d 895 (10th Cir. 1959), upon which petitioners rely (Pet. 11-12), is likewise distinguishable. Unlike this case, the court in *Cravens* did not find that the allowance of an immediate deduction for the feed grain there involved would create a material distortion of income. Indeed, as the court below observed (Pet. App. B-8), *Cravens* turned on the facts that there was a drought and that cattle feed was in short supply so that the taxpayer's purchase assured that he would receive preferential delivery of feed (*id.* at 899). To the extent that *Cravens*, standing alone, might be subject to a broader interpretation, the Tenth Circuit's later decision in *Cattle Feeders Tax Committee* v. *Shultz*, 504 F. 2d 462 (1974), indicates that it should not be so interpreted. In *Cattle Feeders*, the Tenth Circuit refused to enjoin enforcement of a published revenue ruling (*id.* at 463 n.1) that barred immediate deduction of feed costs when such a deduction would distort income. In so holding, the court observed that Sections 446 and 461(a) empower the Commissioner to compute taxable income in a manner that will clearly reflect income (*id.* at 465-466).

Finally, contrary to petitioners' assertion (Pet. 7-9), the decision below does not require all farmers to tie their deductions for feed grain expenditures to the period in which that feed grain is consumed. It would require such treatment only where, as in the present case, the facts



show that the claiming of the deduction in the year of the expenditure or the accrual would result in a distortion of income.[2]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
*Solicitor General*

JANUARY 1979

---

[2]The Tax Reform Act of 1976 in large part eliminates the problem presented by this case for taxable years beginning after December 31, 1975. Under Section 464, added by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1536, certain farming syndicates may claim deductions for "amounts paid for feed, seed, fertilizer, or other similar farm supplies" only during the taxable year in which they were used.

DOJ-1979-01